

Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:FIP:B04
PLR-139544-07

Date:
November 17, 2008

Taxpayer:
State:

Dear :

This responds to your representative's letter of August 31, 2007, as supplemented, requesting rulings under the Internal Revenue Code.

Facts

Taxpayer represents as follows:

Taxpayer is a company engaged in the business of selling life insurance, annuities, and other forms of insurance contracts and is taxable under part I of subchapter L of the Internal Revenue Code.

Taxpayer and two of its subsidiaries propose to offer Funding Agreement to institutional investors such as money market funds, security lending firms, asset managers, banks, trusts, and other financial institutions. Funding Agreement will also be offered to foreign investors that are unrelated to Taxpayer, including foreign trusts.

Funding Agreement, which can be issued as either a general account or separate account product, has been approved by the insurance regulator of State. The purchaser of Funding Agreement will pay Taxpayer a specified amount, which Taxpayer will credit (less specified expenses charges) to an Accumulation Fund. Taxpayer will credit interest to the Accumulation Fund at a specified guaranteed rate. Taxpayer will pay amounts from the Accumulation Fund to the contract holder on specified dates, and

the balance at maturity, which will fully discharge Taxpayer's obligation under Funding Agreement.

At maturity, the contract holder may apply the balance of the Accumulation Fund to purchase from Taxpayer a contract that will qualify as a period certain annuity(ies) for purposes of the Code. The annuity purchase rate will be determined based upon the lesser of (a) the current rates offered by Taxpayer at the time of such annuity purchase or (b) guaranteed purchase rates specified in Funding Agreement.

Under State law, issuing an instrument such as Funding Agreement constitutes doing an insurance business notwithstanding that such an instrument may not be an insurance contract as defined by State law.

Requested Rulings

Taxpayer requests rulings that:

1. The liabilities under Funding Agreement will be treated as § 807(c)(3) reserve items; and,
2. Amounts credited by the Taxpayer to a policyholder under a Funding Agreement constitute payments of interest for purposes of the portfolio interest exception under §§ 871 and 881.

Law and Analysis

Requested Ruling #1

Section 807(c)(3) provides that among the items taken into account in determining the decrease/increase for any taxable year in certain reserves of a company taxable under part I of subchapter L are "[t]he amounts (discounted at the appropriate rate of interest) necessary to satisfy the obligations under insurance and annuity contracts, but only if such obligations do not involve (at the time with respect to which the computation is made under this paragraph) life, accident, or health contingencies."

Section 807 was enacted as part of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (1984). The underlying Conference Report indicates that "[t]he conference agreement generally follow[ed] the Senate amendment". H.R. Rep. 98-861, at 1052 (1984). The Senate report addresses the relevant aspects of § 807 in its discussion of the reserve ratio test component of the definition of a life insurance company:

[T]he bill also provides that, for purposes of determining whether an insurance company is a life insurance company, amounts set aside and held at interest to satisfy obligations under contracts which do not contain permanent guarantees with respect to life, accident, or health contingencies shall not be included in life insurance reserves or in total reserves. Thus, these amounts are not included in either the numerator or the denominator of the qualification fraction when determining whether a company's life insurance reserves and unearned premiums and unpaid losses on noncancellable accident and health insurance contracts comprise more than half its total reserves.

Senate Comm. on Finance, 98th Cong., 2d Sess., Deficit Reduction Act of 1984: Explanation of Provisions Approved by the Committee on March 21, 1984, at 527 (Comm. Print No. 98-169) (1984).

The footnote appended to this passage states:

If these contracts have any insurance or annuity purchase rate guarantees (for life or a fixed term), then the premiums will be taken into income and the interest in the fund will be treated as increases in a reserve item under §§ 807(c)(3) or (4). If there are no guarantees whatsoever, then no income will be taken into account and no reserves will be treated as increased for the purposes of the reserve deduction.

Id., n7.

Here, Funding Agreement has a permanent annuity purchase rate guarantee and the amounts held thereunder are for the purpose of funding a contract that provides for a fixed term annuity settlement option. The amounts held under Funding Agreement are amounts necessary to satisfy the obligations under an annuity contract which do not involve life, accident, or health contingencies and therefore are reserve items under § 807(c)(3).

Requested Ruling #2

Section 871(a)(1)(A) provides that, except as provided in subsection (h), there is a tax of 30 percent of the amount received from sources within the United States by a nonresident alien (NRA) individual as interest. Section 871(h) provides that in the case of portfolio interest received by a NRA individual from sources within the United States, no tax shall be imposed under paragraph 871(a)(1)(A). The qualifications for interest paid on registered obligations and for interest paid on obligations that are not registered

to be deemed portfolio interest are set forth in § 871(h)(2). Similar rules are provided at §§ 881(a)(1) and 881(c), respectively, for foreign corporations.

Revenue Procedure 2008-7, 2008-1 I.R.B. 229, provides a list of areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (International) relating to matters on which the Internal Revenue Service will not issue letter rulings. Because of the inherently factual nature of the inquiry, and in the interest of sound tax administration, section 4.01(4) of Rev. Proc. 2008-7 provides that the IRS will not ordinarily issue letter rulings on whether the income earned on contracts that do not qualify as annuities or life insurance contracts because of the limitations imposed by § 72(s) or § 7702(a) is portfolio interest as defined in § 871(h). Section 4.04(5) of Rev. Proc. 2008-7 provides a similar limitation for letter rulings under § 881(c).

In this case, in the interest of sound tax administration, we decline to rule on whether the amounts credited by the Taxpayer to a policyholder under a Funding Agreement constitute payments of interest for purposes of the portfolio interest exception under §§ 871 and 881. However, notwithstanding that the Funding Agreement qualifies for reserve treatment under § 807(c)(3) the Funding Agreement is a debt instrument under which the Taxpayer pays interest.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including application of § 848.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/S/

Sheryl B. Flum
Chief, Branch 4
(Financial Institutions & Products)